# 4 Federal Tax Cases To Watch In The 2nd Half Of 2019, 2019 Law360 193-11

July 12, 2019



**Author:** Amy Lee Rosen

## Summary

Federal courts will grapple with complex tax cases for the remainder of the year, from tax refund ownership among affiliated groups to the economic substance doctrine, whether an IRS summons can get a law firm's client information and who gets a domestic manufacturing deduction. Here, Law360 explores four federal cases worth monitoring over the next six months.

## Body

Federal courts will grapple with complex tax cases for the remainder of the year, from tax refund ownership among affiliated groups to the economic substance doctrine, whether an IRS summons can get a law firm's client information and who gets a domestic manufacturing deduction.

The U.S. Supreme Court and other federal courts will take on intricate tax cases in the coming months. (AP)Here, Law360 explores four federal cases worth monitoring over the next six months.

Rodriguez v. FDIC

In its next term, the U.S. Supreme Court will decide whether a folded Colorado bank should receive a $4.1 million tax refund in a dispute with its bankrupt parent company when the court hears Rodriguez v. Federal Deposit Insurance Corp.

The trustee for United Western Bancorp Inc., which is in Chapter 7 bankruptcy, petitioned the Supreme Court in April in a bid to overturn (*2019 Law360 123-195*) district and circuit court decisions that found subsidiary United Western Bank was entitled to the $4.1 million because it endured the losses that formed the basis of the refund.

The Supreme Court agreed to hear the case (*2019 Law360 179-31*) in June, and its decision could bring consistency to an unsettled area of law in which substantial amounts of money are at stake, according to Victoria J. Haneman, a professor at Creighton University School of Law.

"There is a circuit split over the issue of tax refund ownership among affiliated groups - with some lower courts applying a rule that a refund automatically belongs to the subsidiary, rather than the parent, unless there is a clear agreement with the parent to the contrary," she said.

David C. Blum, deputy chairman of the tax practice group at Akerman LLP, told Law360 that if the parent owns the refund, then the subsidiary may be treated merely as one of the corporate parent's creditors. That would mean that if a parent company went bankrupt, the refund would become part of the bankruptcy estate that all creditors, including the subsidiary that owned the refund, would compete for as they tried to get repaid, he explained.

"There will be a significant and lasting economic impact to this ruling when you consider that tens of thousands of corporate tax returns are filed annually, and refunds for consolidated groups could run into the hundreds of millions of dollars," Blum said. "Companies and creditors must have certainty of who owns an IRS refund."

The case is Simon E. Rodriguez v. Federal Deposit Insurance Corp., case number 18-1269, in the U.S. Supreme Court.

Tucker v. Commissioner

The former CEO of investment firm Waddell & Reed Financial Inc. is asking the Supreme Court to examine whether the U.S. Tax Court had properly denied nearly $40 million for losses because lower courts found those transactions lacked economic substance.

Keith A. Tucker filed a petition (*2019 Law360 189-136*) with the Supreme Court in July arguing that the Fifth Circuit's reliance on the economic substance doctrine, which can determine whether a transaction has a purpose besides reducing tax liability, was incorrect in the court's decision on whether a complex foreign currency option investment transaction was designed to produce artificial tax losses.

The Fifth Circuit upheld a Tax Court decision from 2017 backing the Internal Revenue Service's denial of a $40 million deduction that Tucker sought based on losses from foreign currency trades, finding that the losses had been artificially generated "by gaming the tax code." The IRS' disallowance of the loss deduction in 2000 resulted in a $15.5 million tax liability as well as a $6.2 million penalty, the opinion said.

Tucker claimed his deduction in relation to an affiliated entity's foreign currency trades that generated a loss, which he passed on to his personal income tax return through an S corporation he owned, according to court documents.

Tucker is an important case to watch, Blum said, because of how it relates to the economic substance doctrine, which the Supreme Court has not addressed in over four decades and has led to conflict among the circuits.

"This conflict has great practical importance as to the role of, if and how, the courts evaluate a transaction, after the fact, that otherwise satisfies the technical provisions of the code," Blum said. "Taxpayers need to know where the line is drawn to engage in proper and predicable tax planning. Such planning should not be treated differently depending on the applicable circuit."

The case is Keith A. Tucker et al. v. Commissioner of Internal Revenue, case number 19-41, in the U.S. Supreme Court.

Taylor Lohmeyer Law Firm v. U.S.

This case involving Taylor Lohmeyer Law Firm PLLC is a crucial one because the outcome could change the extent to which the Internal Revenue Service can obtain information about a law firm's clients.

In May, a Texas district court found that the government (*2019 Law360 136-131*) can enforce an IRS summons for client information from the law firm because it failed to show that attorney-client privilege protected that information.

According to court documents, the U.S. filed for leave to serve a John Doe summons on Oct. 4, 2018, and served Taylor Lohmeyer the following Oct. 17, demanding that the firm provide names and other documents related to certain taxpayers that were clients of the firm from Jan. 1, 1995, to December 2017. The summons sought information on any U.S. clients that the firm's agents helped to acquire or form any foreign entity, open or maintain any foreign account or conduct any foreign financial transaction, according to a filing by the government (*2019 Law360 45-172*). The firm is appealing the case.

The tax bar will be watching the case because it may represent a new trend in IRS investigations, Charles M. Ruchelman, a member at Caplin & Drysdale Chtd., told Law360.

"It's a tactic that violates fundamental principles of protection and confidentiality in the U.S. legal system," he said. "A client should be able to speak candidly with an attorney without fear that the communications will wind up in the hands of the government."

The case is Taylor Lohmeyer Law Firm PLLC v. U.S.A., case number 5:18-cv-01161, in the U.S. District Court for the Western District of Texas, San Antonio Division.

AT&T Advertising v. U.S.

The U.S. Court of Federal Claims is examining a tax refund dispute between the IRS and AT&T Advertising LP over when and how a company can take a domestic manufacturing deduction under *Internal Revenue Code Section 199* (*26 U.S.C. § 199*), which was repealed by the Tax Cuts and Jobs Act (97 P.L. 115) but is still relevant to many who previously claimed the deduction.

Section 199 was created to help assist in U.S. job creation when Congress passed the American Jobs Creation Act of 2004 (108 P.L. 357), which provided a phased 3%, then 6% and eventually 9% deduction on either qualified production activity income or the taxpayer's taxable income - whatever was lower. The deduction was available for domestic production gross receipts from the taxpayer's manufacture, production, growth or extraction of tangible personal property such as computer software and sound recordings, but not land and buildings.

AT&T is seeking a large tax refund for *IRC 199* deductions for printing the Yellow Pages directory, but the IRS denied those deductions. The case hinges on whether a joint venture of AT&T and Cerberus Capital Management LP that published Yellow Pages telephone directories could claim (2016 Law360 60-4) $123 million in payments it was ordered to make in connection with a disputed manufacturing-related deduction between 2005 and 2009.

The case is important, according to Kevin Spencer, a partner with McDermott Will & Emery LLP, because many other companies face the same issue and AT&T will likely be decided on who has the "benefits and burdens" of owning the property while it was produced and manufactured.

"AT&T used a contract printer to print the Yellow Pages, which is expressly permitted by the regulations, (*Treas. Reg. Section 1.199-3(f)(1)*) but the IRS does not like the refund claim because it believes that only one taxpayer can claim the deduction," Spencer said.

At the end of June, the government said that because AT&T did not manufacture directories and did not bear the benefits and burdens of owning them, the court should prevent the company from taking deductions. In addition, the government argued, because the printers already claimed Section 199 deductions for producing those directories, it would be against congressional intent to allow AT&T to also take the deductions because that would go against the standard of allowing a given deduction to only one taxpayer.

In 2013, the Tax Court ruled on a similar Section 199 issue in *ADVO Inc. v. Commissioner (141 T.C. 298)*, holding that a taxpayer could not take a Section 199 deduction because the taxpayer did not bear the "benefits and burdens of ownership" of the direct advertising materials, but Spencer said the Tax Court in ADVO misunderstood how the credit worked and misapplied the calculation, he said.

"Most practitioners think the Tax Court got it very wrong in ADVO, so we are all hoping that a new judge and court will be more methodical in its analysis" of AT&T, Spencer said.

The case is AT&T Advertising LP et al. v. U.S., case number 1:16-cv-00272, in the U.S. Court of Federal Claims.

--Additional reporting by Mike Curley, Yvonne Juris, Vidya Kauri, Natalie Olivo, Eli Flesch and Jack Newsham. Editing by John Oudens and Tim Ruel.